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Froth Rises in Vancouver Market

BY KIM MACKRAEL
AND RITA TRICHUR

Rising land costs are putting added pressure on Vancouver's frothy housing market, but many developers anticipate the Canadian city's growing population and international appeal will continue to support the price increases they are passing on to consumers.

The average price for high-density land in the Vancouver region reached 152 Canadian dollars (US$116) a square foot of buildable land in the last quarter of 2015, nearly three times what it was in early 2006, according to data collected by research firm RealNet Canada Inc. Land prices were up about 12% in that quarter alone from the previous quarter, the firm's data indicates.

"The land market is more expensive than it's ever been and more competitive than it's ever been," said Kirk Kuester of Colliers International in Vancouver. "The economics are very challenging for those that are looking to buy."

Blake Hudema, president of via Allegro Development Co. Ltd., said he was part of a group that bought a lot near Vancouver's fast-growing Cambie corridor for C$225 per buildable square foot about six months ago.

The condominiums the group is building will likely sell for about C$850 a square foot before taxes when they go up for presale later this year, he said.

Two years ago, Mr. Hudema estimates the same property would have sold for about C$175 a buildable square foot, and the condominium units would have been priced in the range of C$750 a square foot.

Nic Paolella, development manager at Marcon Developments Ltd., said his firm bought a town-house development site on Granville Street in the west coast city's Marpole neighborhood last October for C$307 per buildable square foot. If the same site was listed on the market today, Mr. Paolella said it would likely go for C$426 a buildable square foot, reflecting about a 39% increase.

C$152

Average price per square foot for high-density land in the Vancouver region

Mr. Paolella said he wasn't yet prepared to say how much the Marpole town houses will cost. But had Marcon bought the land at the higher price point, he said, the firm would look to pass along the additional cost to the home buyer. "Ultimately, if we had bought it at a higher cost, we can't just absorb that into our margins. It has to get passed on," he said.

Home prices in the Vancouver region rose by more than 22% to C$795,500 in February from a year earlier, according to a Canadian Real Estate Association index. In the Toronto area, another increasingly expensive Canadian market, home prices were up more than 11% year over year, reaching C$589,000.

At some point, developers no longer will be able to pass on costs to buyers, experts say. "It's happened in every real-estate cycle in history," Mr. Kuester said. "At some point, the tide goes out."

Developers say higher Vancouver prices continue to be justified because of the limited supply—the city is bounded by mountains and ocean—and continued demand.

The slowdown in Alberta, the center of Canada's oil production, means more people are moving to British Columbia and Ontario in search of work. At the same time, historically low interest rates and the weak Canadian dollar make real estate in Canada an especially attractive option for both domestic and foreign buyers.

Developers in Toronto also face constraints when buying land. That city is hemmed in by the world's largest permanent greenbelt, nearly two million acres of protected land to prevent sprawl.

Todd Cowan, managing partner of Toronto-based Capital Developments Ltd., said that 10 years ago, land prices made up about 10% to 15% of a development's total cost, depending on the location. Now, they can account for 15% to 25% of total costs.

Mr. Cowan said land in the Yonge and Eglinton area of Toronto, which is on the city's transit line, would have cost around C$50 per buildable square foot in 2006. That same land is now likely to sell for closer to C$80 or C$100, Mr. Cowan said. During the same period and for the same neighborhood, end unit prices have risen to roughly C$700 a square foot from C$450 to $500 a square foot in 2006, he said.

"It's very difficult to find a land," said Steve Di Fruscia, chief executive of Tianco Group Inc., the Canadian subsidiary of China's Gansu Tianqing Real Estate Co. "Even when you do find one, you often end up in bidding wars with other deep-pocketed developers."

Toronto-Dominion Bank economist Diana Petramala said she expects the Vancouver and Toronto housing markets to cool down in the second half of 2016 and into 2017 as prices in both cities become less affordable. Ms. Petramala noted that high levels of activity have left both cities vulnerable to a gradual rise in interest rates.

Last December, the federal government announced it would require higher down payments for homes selling between C$500,000 and C$1 million.

Finance Minister Bill Morneau said the move was aimed at containing risk in the housing market and pointed to concerns about Vancouver and Toronto in particular.